



IN THE
Supreme Court of the United States
OCTOBER TERM, 1975

No. **75-1312**

DON E. WILLIAMS,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

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Petitioner prays that a Writ of Certiorari issue to review the judgments of the United States Court of Appeals for the Seventh Circuit entered in the above case on December 16, 1975.

OPINIONS BELOW

The opinion of the United States Tax Court is reported at 62 T.C. No. 19. The opinion of the Court of Appeals for the Seventh Circuit is not yet officially reported.

JURISDICTION

The judgment of the Court of Appeals for the Seventh Circuit was made and entered on December 16, 1975 and copies thereof are appended to this petition. The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTIONS PRESENTED

I. Whether the delivery by Don E. Williams Company, an accrual basis taxpayer, of a promissory note with a face value of \$31,589.32 secured by an assignment by the President and Vice President of their interests in the Profit Sharing Trusts, an assignment by the President of his 4,180 shares of \$10.00 par value common stock of the Don E. Williams Company and personally guaranteed by the President, Vice President and Secretary-Treasurer of Don E. Williams Company constituted the "payment" under 26 U.S.C. § 404 to the Profit Sharing Trust of Don E. Williams Company's \$31,589.32 designated contribution to the Profit Sharing Trust for the year ended April 30, 1967.

II. Whether the delivery by Don E. Williams Company, an accrual basis taxpayer, of a promissory note with a face value of \$34,333.26 secured by an assignment by the President and Vice President of their interests in the Profit Sharing Trusts, an assignment by the President of his 4,180 shares of \$10.00 par value common stock of the Don E. Williams Company and personally guaranteed by the President, Vice President and Secretary-Treasurer of Don E. Williams Company constituted the "payment" under 26 U.S.C. § 404 to the Profit Sharing Trust of Don E. Williams Company's \$34,333.26 designated contribution to the Profit Sharing Trust for the year ended April 30, 1968.

III. Whether the delivery by Don E. Williams Company, an accrual basis taxpayer, of a promissory note with a face value of \$35,337.86 secured by an assign-

ment by the President and Vice President of their interests in the Profit Sharing Trusts, an assignment by the President of his 4,180 shares of \$10.00 par value common stock of the Don E. Williams Company and personally guaranteed by the President, Vice President and Secretary-Treasurer of Don E. Williams Company constituted the payment under 26 U.S.C. § 404 to the Profit Sharing Trust of Don E. Williams Company's \$35,337.86 designated contribution to the Profit Sharing Trust for the year ended April 30, 1969.

STATUTES, FEDERAL RULES, AND REGULATIONS INVOLVED

THE INTERNAL REVENUE CODE OF (1954),
§§ 404(a)(3)(A) & (6), 26 U.S.C. §§ 404(a)

(3) Stock bonus and profit-sharing trusts:

(A) Limits on deductible contributions. In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 501(a), in an amount not in excess of 15 percent of the compensation otherwise paid or accrued during the taxable year to all employees under the stock bonus or profit-sharing plan. . . .

(6) Taxpayers on accrual basis:

For purposes of paragraphs (1), (2), and (3), a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof).

STATEMENT

This appeal arises out of a complaint brought by the Petitioner, Don E. Williams Company, (hereinafter "Dewco") against the Respondent, Commissioner of Internal Revenue (hereinafter "C.I.R."). In its complaint Petitioner asked for a redetermination of the deficiency set forth by the C.I.R. in his Notice of Deficiency dated May 25, 1971.

The deficiency, which Petitioner feels is in error, as determined by the C.I.R. is in income tax as follows and results from disallowance of tax deductions.

<u>Fiscal Year Ending</u>	<u>Amount of Disallowance</u>	<u>Amount/Tax Assessed</u>
April 30, 1967	\$31,589.32	\$15,162.87
April 30, 1968	\$ 2,743.94	\$ 1,360.64
April 30, 1969	\$ 1,004.60	\$ 530.42

The commissioner erroneously determined for fiscal year ending April 30, 1967, that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on demand promissory note in the amount of \$31,589.32, and within the "grace period" allowed an accrual basis taxpayer by § 404 (a)(6) of the Internal Revenue Code of 1954 to the Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of § 404 (a) of the Internal Revenue Code of 1954.

The commissioner erroneously determined for fiscal year ending April 30, 1968, that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on demand promissory note in the amount of \$34,333.26, within the "grace period" allowed an accrual

basis taxpayer by § 404 (a)(6) of the Internal Revenue Code of 1954 to the Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of § 404 (a) of the Internal Revenue Code of 1954.

The commissioner erroneously determined for fiscal year ending April 30, 1969, that the delivery of the Petitioner's secured, interest-bearing, negotiable and payable on demand promissory note in the amount of \$35,337.86, within the "grace period" allowed an accrual basis taxpayer by § 404 (a)(6) of the Internal Revenue Code of 1954 to the Don E. Williams Company Profit-Sharing Trust, did not constitute payment within the ambit of § 404 (a) of the Internal Revenue Code of 1954.

The facts and exhibits were stipulated to by the parties and the case was submitted to the Tax Court of the United States.

Judgment was entered for the Respondent, with three judges dissenting, assessing deficiencies in income tax due from Petitioner as set forth above.

On appeal, the United States Court of Appeals for the Seventh Circuit affirmed, however, in doing so they declined to follow decisions of the Third, Ninth, and Tenth Circuits and also a district court decision in the Seventh Circuit.

REASONS FOR GRANTING THE WRIT

The decision below should be reviewed because it involves a direct conflict with decisions of the Courts of Appeals in the Third, Ninth and Tenth Circuits.¹ In those cases it was held that a taxpayer's note is payment within the meaning of § 404(a) of the Internal Revenue Code.

In the *Sachs* case, 208 Fed. 313 (C.A. 3, 1953), which dealt with two separate cases in which the taxpayer transferred its own demand note to the trustee of the pension fund, the Court in reversing the Tax Court stated at page 315:

Payment or paid does not invariably mean in cash. . . . If a check is sufficient, we see no reason why a negotiable demand note payable at a bank is not likewise sufficient.

The Court in that case was more interested in the value of the notes. They felt it was more important to determine if something of value had been received.

In the *Time Oil Co.* case, 26 T.C. 1061 (1956), reversed, 258 F. 2d 237 (C.A. 9, 1958), in which the corporation delivered non-interest bearing demand notes to the trustee and later replaced the notes with stock, the court was asked to rule as to whether the delivery constituted payment and the year in which the deduction could be taken.

¹ See *Slaymaker Lock Co. v. Commissioner*, 18 T.C. 1001 (1952), reversed sub nom. *Sachs v. Commissioner*, 208 F.2d 313 (3rd Cir. 1953); *Time Oil Co. v. Commissioner*, 26 T.C. 1061 (1956) reversed 258 F.2d 237 (9th Cir. 1955); *Wasatch Chemical Co. v. Commissioner*, 37 T.C. 817 (1962), reversed 313 F.2d 893 (10th Cir. 1963).

The Court stated that delivery of the notes constituted payment by Time Oil Co. as of the delivery date. That date would determine the year of deductibility.

This line of reasoning has been expanded and clarified in *Wasatch Chemical Co.*, 37 T.C. 817 (1962), reversed, 313 F. 2d 843 (C.A. 10, 1963). The Court there stated at page 846:

The authorities thus hold that payment does not mean payment in cash. In the case at bar upon delivery of petitioner's notes, payment was thereby made in the amount of the then value of these notes and in that amount was the equivalent of cash.

In *Wasatch*, *supra*, the issue was whether delivery of the company's unsecured, interest-bearing promissory notes with stated maturities constituted payment to allow them as deductions on the company's income tax return.

The Court addressed itself more to the issue of whether anything of value was delivered to the trustee and if so, what was the value.

The Appellate Court decision in the case at bar also conflicts with the decision in *Advance Construction Co., Inc. v. U.S.*, 356 F.Supp. 1267 (N.D. Ill. 1972) a Seventh Circuit district court case involving a suit for a tax refund. That court also held that a taxpayer's term promissory note was a proper form of contribution under § 404(a).

At the present time, Appellant is aware of three (3) other cases which are on appeal in various circuits in which the same issue is presented.² It has been over

² *Coastal Electric Corporation v. C.I.R.* T.C. Memo 1975-231; *Lancer Clothing Corporation v. C.I.R.* T.C. Memo 1975-180; *Patmon Young & Kirk Professional Corporation v. C.I.R.* T.C. Memo 1975-185.

twelve years since the *Wasatch* case, *supra*, was decided and it is apparent that taxpayers by their course of conduct have been relying on the decisions cited by Appellant. It should also be noted that since the *Wasatch* case, Congress has passed several major pieces of legislation dealing with the Internal Revenue Code without considering this question. However, in the Pension Reform Act of 1974, Congress did make a change which allows cash basis taxpayers to take a deduction for a contribution to a qualified plan if the contribution is made by the time the return is due. This put cash and accrual basis taxpayers on parity and in effect was a liberalization by Congress.³ It is submitted that these changes support Appellant's position and the cases relied upon.

The Petitioner requests this court to exercise its unique jurisdictional powers in order to establish a reliable course of conduct for business and to alleviate the hardships and uncertainty caused by the current conflict between Circuits.

This court has not settled this question. The Appellate Court in its opinion and the Respondent in its brief relied on *Eckert v. Burnet*, 283 U.S. 140 (1931) and *Helvering v. Price*, 309 U.S. 409 (1940). However, these cases involved the giving of a note for a debt which was an already worthless debt. In addition the notes were due in the year following the claimed deduction, a situation not in accord with the facts in the case at bar where the Petitioner gave a demand note, in the year of the deduction.

The *Eckert* case stands for the proposition that acquisition of a worthless debt cannot be charged off so as

³ Internal Revenue Code, Section 404 (a)(6), 1954.

to take advantage of a bad debt deduction. In *Price*, it was held that an ordinary loss is not sustained by a guarantor who gives the person guaranteed a personal note not payable within the taxable year. It is submitted that these two cases do not stand for the all-inclusive proposition that promissory notes are a mere promise to pay and not the equivalent of cash or property with a cash value.

The cases relied upon by this Petitioner dealt directly with what constitutes payment for tax deductibility purposes and held that payment in cash is not required. It is Petitioner's position that the cases relied upon by the Courts of the Third, Ninth and Tenth Circuits are relevant and controlling on all material issues in the case at bar.

Petitioner believes these cases have also presented another issue which has created a conflict which would be settled by the Supreme Court's review in this case. That is whether Federal Tax Law or the Uniform Commercial Code adopted by virtually every State is controlling in determining what constitutes payment. This issue has always appeared in the cases cited by Appellant and the circuits again have disagreed in their holdings. Since taxpayers are striving for uniformity, Appellant urges that this conflict is greatly in need of resolution.

CONCLUSION

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

Opinion Of United States Tax Court

UNITED STATES TAX COURT

62 T. C. No. 19

DON E. WILLIAMS COMPANY,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 5946-71. — Filed May 14, 1974.

Petitioner contributed to its profit-sharing plan for three taxable years by issuing its demand, interest-bearing, promissory notes secured by pledges of its principal shareholders. Petitioner paid the notes in each of the succeeding years.

HELD: The promissory notes do not constitute "payment" required by section 404(a), I.R.C. 1954 and petitioner's deductions for the contributions are denied. *Logan Engineering Co.*, 12 T.C. 860 (1949), followed. *Sachs v. Commissioner*, 208 F. 2d 313 (C.A. 3, 1953); *Time Oil Co. v. Commissioner*, 258 F. 2d 237 (C.A. 9, 1958); and *Wasatch Chemical Co. v. Commissioner*, 313 F. 2d 843 (C.A. 10, 1963), not followed.

DONALD P. COONEY, for the petitioner.

ALLAN E. LAND, for the respondent.

OPINION

GOFFE, *Judge*: The Commissioner determined deficiencies in petitioner's income tax for the taxable years ended April 30, 1967; April 30, 1968; and April 30, 1969, in the amounts of \$15,162.87; \$1,360.64; and \$530.42, respectively. The sole issue for decision is whether petitioner's promissory notes issued and delivered to the trustees of the trust for its profit-sharing plan constitute "payment" as required by section 404(a) of the Internal Revenue Code of 1954¹ thus entitling petitioner to deductions for the face amounts of the notes in the taxable years the notes were issued.

All of the facts have been stipulated. The stipulation of facts and exhibits are incorporated herein and adopted as our findings of fact. Only the facts necessary to an understanding of our opinion will be summarized herein.

Petitioner is a corporation organized under the laws of the State of Illinois with principal offices in Moline, Illinois. Its principal business activity is that of a manufacturers representative and wholesaler for factory tools and supplies.

Petitioner maintains its books and records and files its income tax returns on the accrual method of accounting using a fiscal year ending on April 30. Its returns for the taxable years before us were filed with the district director of internal revenue at Chicago, Illinois.

Petitioner has a profit-sharing plan which has been "qualified" since 1964. The trustees of the trust for the profit-sharing plan are its bank and the three principal shareholders of petitioner, who are also petitioner's officers.

Toward the end of each of its taxable years before us, the board of directors of petitioner authorized con-

¹ All section references are to the Internal Revenue Code of 1954, as amended, unless otherwise noted.

tributions to petitioner's profit-sharing plan and in the month immediately following the close of its taxable years petitioner delivered to the trustees its interest-bearing secured demand promissory notes for face amounts equal to the deductions claimed as employer contributions to the profit-sharing plan. Such amounts were accrued as liabilities on the books of petitioner at the close of each of the taxable years. The notes issued in 1967 and 1968 bore interest at the rate of 6 percent and the note issued in 1969 bore interest at the rate of 8 percent. Interest was payable at maturity. The officers and principal shareholders of petitioner, each as principals, jointly and severally, executed the notes as accommodation makers. The notes were secured solely by collateral owned by the accommodation makers and consisted of some stock in petitioner owned by one shareholder and the respective interests of two of the shareholders in the profit-sharing plan. The value of the collateral pledged by the two shareholders combined with the net worth of the third shareholder, who pledged nothing, exceeded the face amounts of the notes.

Toward the end of each of its taxable years, petitioner paid each of the demand notes it had issued at the beginning of such year, together with the accrued interest thereon.

Petitioner deducted on its income tax returns the face amounts of the notes issued to the trustees of the profit-sharing plan and the Commissioner, in his statutory notice of deficiency, disallowed the deductions claimed, less the payments on the notes, on the grounds that the notes did not represent "payments" of the contributions within the meaning of section 404(a).

Section 404(a) and its predecessor, section 23(p) of the Internal Revenue Code of 1939, allow deductions for contributions *paid* by an employer to a qualified profit-sharing plan. Such contributions are, by the terms of section 404(a), not deductible as trade or business expenses under section 162 nor are they deductible as expenses for the production of income under section 212.

The deduction is allowable only if paid within the taxable year or, in the case of taxpayers on the accrual method of accounting, if paid within the time in which the income tax return of the employer is due to be filed. Sec. 1.404(a)-1(c),² Income Tax Regs. Other exceptions provide for situations not applicable here.

It is clear from the regulations that the contribution must be paid. The validity of the regulations is not challenged. Petitioner contends that the notes which it issued represent payment and respondent contends that notes do not represent payment for the purposes of section 404(a). Respondent relies upon four of our decisions and petitioner relies upon the decisions of three Courts of Appeals which reversed three of these cases.

The four cases involved, in chronological order, are *Logan Engineering Co.*, 12 T.C. 860 (1949); *Slaymaker Lock Co.*, 18 T.C. 1001 (1952), reversed sub nom. *Sachs*

² SEC. 1.404(a)-1

(c) Deductions under section 404(a) are generally allowable only for the year in which the contribution or compensation is paid, regardless of the fact that the taxpayer may make his returns on the accrual method of accounting. Exceptions are made in the case of overpayments as provided in paragraphs (1), (3), and (7) of section 404(a), and, as provided by section 404(a)(6), in the case of payments made by a taxpayer on the accrual method of accounting not later than the time prescribed by law for filing the return for the taxable year of accrual (including extensions thereof). This latter provision is intended to permit a taxpayer on the accrual method to deduct such accrued contribution or compensation in the year of accrual, *provided payment is actually made* not later than the time prescribed by law for filing the return for the taxable year of accrual (including extensions thereof) but this provision is not applicable unless during the taxable year on account of which the contribution is made the taxpayer incurs a liability to make the contribution, the amount of which is accruable under section 461 for such taxable year. See section 461 and the regulations thereunder. There is another exception in the case of certain taxpayers who are required to make additional contributions as a result of the Act of June 15, 1955 (Public Law 74, 84th Cong., 69 Stat. 134), and the regulations thereunder. [Emphasis added.]

v. Commissioner, 208 F. 2d 313 (C.A. 3, 1953); *Time Oil Co.*, 26 T.C. 1061 (1956), reversed 258 F. 2d 237 (C.A. 9, 1958); and *Wasatch Chemical Co.*, 37 T.C. 817 (1962), reversed 313 F. 2d 843 (C.A. 10, 1963).

An appeal in the instant case would lie in the Court of Appeals for the Seventh Circuit which has not considered the issue.

With all due respect to the Courts of Appeals for the Third, Ninth and Tenth Circuits, we decline to follow their decisions. Instead, we shall continue to follow our decisions, two of which were reviewed by the Court and not burdened with concurring or dissenting opinions. We do so because we continue to believe our decision was correct in the first case, *Logan Engineering, supra*. In that case, we construed section 23(p)(1) of the Internal Revenue Code of 1939, the predecessor of section 404(a) with which we are now concerned. We pointed out that the word "paid" used in the statute should be given its ordinary and usual meaning, "to liquidate in cash." *P. G. Lake, Inc., v. Commissioner*, 148 F. 2d 898 (C.A. 5, 1945); cf. *Commissioner v. Drovers Journal Pub. Co.*, 135 F. 2d 276, 278 (C.A. 7, 1943). However, delivery of a check satisfies the requirement of a liquidation in cash because it represents a conditional payment, but a promissory note is merely a negotiable promise to pay. *Estate of Modie J. Spiegel*, 12 T.C. 524 (1949).

We based our decision in *Logan Engineering, supra*, on legislative intent derived from the Report of the Ways and Means Committee on the Revenue Revision Act of 1948, 80th Cong. Rept. No. 2087, p. 13, wherein it stated, concerning section 23(p)(1)(E), that "An employer on the accrual basis of accounting may under existing law deduct contributions *actually paid* within the first 60 days of the subsequent year." (Emphasis added.) The report explained the Committee's recommendation to extend the time from one month to two months and 15 days within which an accrual basis employer could pay the contribution to the pension or profit-sharing plan after the close of the taxable year and yet be entitled to

deduct the contribution. *Sioux Tribe v. United States*, 316 U.S. 317, 329-330 (1942). The above-quoted language appears in the regulations set forth in footnote 2 which petitioner does not challenge as invalid.

We followed *Logan Engineering, supra*, in *Slaymaker, supra*, which was reversed sub nom., *Sachs v. Commissioner, supra*, by the Court of Appeals for the Third Circuit.

The Third Circuit bases its decision on *Miller v. Commissioner*, 164 F. 2d 268 (C.A. 3, 1947), which involved section 24(c)(1) of the Internal Revenue Code of 1939. That section covered the payment of expenses and interest following the close of a taxable year and is the predecessor of section 267 of the Internal Revenue Code of 1954.

Section 267, by its specific terms, applies to the disallowance of deductions for payments to related taxpayers; i.e., losses, interest, trade or business expenses deductible under section 162 and expenses incurred in the production of income under section 212. The deduction with which we are concerned is allowable only under section 404(a) and that section specifically precludes allowance of a deduction for such contributions under section 162 or section 212.

Because section 404(a) specifically prohibits deduction of the employer contribution under section 162 or section 212 and section 267, by its own terms, applies only to losses, taxes and deductions allowable under sections 162 and 212, section 267 cannot have any bearing upon "payment" under section 404(a). The Third Circuit in *Sachs, supra*, incorrectly drew an analogy between "payment" under section 404(a) and "payment" under other Code sections. "Payment" under section 404(a) should, instead, be interpreted independently in light of the intent of Congress as we explained above.

We also disagree with the Third Circuit when it suggests that there is little difference between a demand promissory note and a check drawn on a bank account.

The notes in *Sachs, supra*, were payable at a bank. In the instant case, the notes were not payable at a bank.

Illinois law, which applies here, embodies alternative B of section 3-121 of the Uniform Commercial Code which provides that a note "payable at a bank is not of itself an order or authorization of the bank to pay it." The analogy of a promissory note payable at a bank and a check as bank draft upon which the Third Circuit relied in *Sachs, supra*, therefore, cannot possibly apply in Illinois. The comparison of a bank draft or check and a promissory note *not* payable at a bank is even more far-fetched when the relationships of the parties are considered.

In the instant case, the officers and principal shareholders of the corporation provided the only security for the notes and they, together with a corporate trustee, were also the trustees who received the notes. In the case of a check drawn on the employer's bank account, however, an intermediate party is involved; i.e., the bank at which the check is presented for payment. If the intermediate party, the bank, is ignored so that the check is not cashed within a reasonable time, the check is no longer equivalent to money. *C. D. Fountain*, 59 T.C. 696, 702 (1973). Cf. *Randall N. Clark*, 58 T.C. 94 (1972).

Delivery of the note to the trust does not extinguish the obligation of the petitioner to contribute to the trust as is clearly demonstrated by section 3-802 of the U.C.C. adopted by Illinois which provides:

Section 3-802. Effect of Instrument on Obligation for Which It Is Given.

(1) Unless otherwise agreed where an instrument is taken for an underlying obligation

- (a) the obligation is pro tanto discharged if a bank is drawer, maker or acceptor of the instrument and there is no recourse on the instrument against the underlying obligor; and

- (b) *in any other case the obligation is suspended pro tanto until the instrument is due or if it is payable on demand until its presentment.* If the instrument is dishonored action may be maintained on either the instrument or the obligation; discharge of the underlying obligor on the instrument also discharges him on the obligation. [Emphasis added.]

* * * * *

If the obligation upon which a note is given is suspended until presentment for payment as the U.C.C. quoted above indicates, it is difficult to see how it can be said that the contribution to the profit-sharing plan has been paid. Although the above-quoted provision of the U.C.C. was not applicable when we decided *Logan Engineering, supra*, *Modie J. Spiegel, supra*, *Slaymaker, supra*, *Time Oil, supra*, and *Wasatch Chemical, supra*, our holdings appear to us to be consistent with the U.C.C.

As we have observed before, Congress imposed the requirement of *payment* upon contributions to pension and profit-sharing plans even though such requirement is not imposed upon other deductions of accrual basis taxpayers. Congress, at the present time, is considering legislation to correct abuses in pension and profit-sharing plans. The Senate bill contemplates amendment of section 503(b) to further prohibit transactions between the trust and related parties, including the employer. Lending between the trust and the employer is prohibited by the terms of the Senate bill. The Report of the Senate Finance Committee accompanying S. 1179 contains the following:

It is intended that prohibited loans include the acquisition by the trust of a debt instrument (such as a bond or note) which is an obligation of a party in interest. (However, the transition rules, described

below, establish special rules regarding certain debt instruments held by the trust on August 21, 1973.) Similarly, the committee intends that it would be a prohibited transaction (in effect, a loan by the trust to the employer) if the employer funds his contributions to the trust with his own debt obligations. [S. Rept. No. 93-383, 93rd Cong., 1st Sess., p. 98 (1973)]

The provision proposed by the Senate is now a part of H.R. 2 which was passed by the Senate on March 4, 1974. The House version of H.R. 2 and the Senate version of H.R. 2 are presently pending before a conference.

Clearly the Senate intends the result our decisions have sought to achieve.

We followed our prior decisions in *Logan Engineering, supra*, and *Slaymaker, supra*, when we decided *Time Oil, supra*. The Court of Appeals for the Ninth Circuit reversed us in that case following the Third Circuit in *Sachs, supra*, and *Miller, supra*. The Ninth Circuit recognized the question to be close but observed that it was unnecessary to set up a conflict of circuits.

Our most recent case, *Wasatch Chemical, supra*, involved five-year unsecured promissory notes, not demand secured notes as we have here; therefore, we applied only our prior decision in *Logan Engineering, supra*. The Tenth Circuit reversed our decision and remanded the case for a determination of the fair market value of the promissory notes. It followed *Sachs, supra*, and *Time Oil, supra*, and concluded that term notes were equivalent to cash. It also pointed out that we recognized that the transfer of real property constituted "payment," citing *Colorado National Bank of Denver*, 30 T.C. 933 (1958). We have no quarrel with the proposition that the "payment" required by section 404(a) can be satisfied with a transfer of property, but a promissory note in the hands of the obligor is not property of the obligor for the purposes of section 404(a). We rejected such a proposition in *Slaymaker*, 18 T.C. 1001, 1006 (1952), and continue to believe it to be unsound.

Our prior decisions are sound and are based on Congressional intent now being reconfirmed by Congress and they are also in harmony with the U.C.C. provisions in Illinois.

We, therefore, continue to hold that the requirement of "payment" of section 404(a) is not satisfied by delivery of promissory notes of the employer seeking the deduction for the contribution to the pension or profit-sharing plan.

Reviewed by the Court.

DECISION WILL BE ENTERED FOR THE RESPONDENT.

IRWIN, J., dissenting: I respectfully disagree with the majority. In my opinion the delivery of petitioner's interest-bearing secured promissory notes payable on demand constituted payment for the purposes of section 404(a). Unlike the majority I would find cash equivalence. Cf. *Cowden v. Commissioner*, 289 F. 2d 20, 24 (C.A. 5, 1961).

I would also dispute the majority's finding for an additional reason. We have previously held that the delivery of property constitutes payment. *Colorado National Bank of Denver*, 30 T.C. 933 (1958). However, the majority summarily determines that since the notes are not property in the hands of the obligor they are not property. I suggest that the proper test of whether the notes constitute property should be directed to whether they are property in the hands of the holders, not the obligors. Cf. *Denver & Rio Grande Railroad Co. v. United States*, 318 F. 2d 922, 924 (Ct. Cl. 1963).

In determining that payment did not occur, the majority further relies upon the Uniform Commercial Code. Without considering the merits of their interpretation, I do not believe that the U.C.C. should be employed

to determine whether payment has occurred for Federal income tax purposes. Whether the delivery of the promissory notes constituted payment for the purposes of section 404(a) is a matter of Federal tax law, not state law. Cf. *Morgan v. Commissioner*, 309 U.S. 78 (1940).

It appears that there is implicit in the majority's reasoning a desire to protect the employees under the plan. However, section 404(a) only requires payment, not payment in cash. In my opinion other provisions of the Code provide the fund with sufficient protection. See, e.g., sections 401(a)(2) and 503(b). Furthermore, the legislative history of section 404(a) reveals only that Congress intended actual payment as a requisite to deduction, not payment in cash. See *Logan Engineering Co.*, 12 T.C. 860, 867 (1949); *Wasatch Chemical Company v. Commissioner*, 313 F. 2d 843, 845 (C.A. 10, 1963), for a discussion of the legislative history. While the majority relies upon *P. G. Lake, Inc. v. Commissioner*, 148 F. 2d 898, 900 (C.A. 5, 1945), for the proposition that the ordinary and usual meaning of the term "payment" is "to liquidate in cash," a review of the cases cited in *P. G. Lake* reveals little foundation for such a proposition. *P. G. Lake* involved constructive payment and the clear implication from the cases relied upon therein is that payment means to liquidate in cash or cash equivalent. See, e.g., *Helvering v. Price*, 309 U.S. 409 (1940). In addition, I believe that the narrow definition adopted by the majority is not in harmony with the widespread use of commercial paper and I, therefore, cannot subscribe to it.

Finally, while the delivery of one's own note as payment might, in substance, be viewed merely as a loan transaction, this factor should not necessarily affect the allowance of the deduction. It seems evident that a corporation may borrow from its pension fund and use the proceeds to meet its contribution requirements provided the transaction does not fall within the prohibitions of section 503. Viewing the instant situation in this light, respondent's proper course of action should be through section 503, not section 404(a). I can find no legislative support or other compelling reason to restrict the meaning of the term "payment" as the majority has done.

QUEALY, J., dissenting: In its majority opinion, the Court reaffirms its earlier decisions with respect to what constitutes payment within the meaning of section 404(a) notwithstanding that three of those decisions have been rejected by Courts of Appeals for the 3rd, 9th and 10th Circuits. See *Sachs v. Commissioner*, 208 F. 2d 313 (C.A. 3, 1953); *Time Oil Co. v. Commissioner*, 258 F. 2d 237 (C.A. 9, 1958); and *Wasatch Chemical Co. v. Commissioner*, 313 F. 2d 843 (C.A. 10, 1963).

More than 10 years have elapsed since the most recent of those cases, during which time the Congress has considered several major revisions of the internal revenue laws and numerous technical amendments without addressing itself to this question. As pointed out in the majority opinion, a restriction upon the use of obligations of the employer as payments to a qualified pension plan was finally incorporated in H.R. 2, different versions of which were passed by the House and the Senate in this the 93d Congress, which are presently pending before a House-Senate conference. Rather than conclude that this belated action on the part of the Congress warrants the reaffirmance by this Court of a position previously rejected by the three appellate courts, I would conclude the opposite.

Notwithstanding the concept that this Court has assumed the role of a "national court" in questions involving the internal revenue laws, we must recognize that the appellate courts are also entitled to make such determinations. At some stage, we must be willing to accept a reversal of our position, even though we may not be wholly convinced of our error. In this situation, I think that we have passed beyond that point. After three reversals and the lapse of more than 10 years, taxpayers should be entitled to rely upon the decisions of the appellate courts.

HALL, J., agrees with this dissent.

APPENDIX B

Opinion Of United States Court Of Appeals For The Seventh Circuit

No. 74-1812

DON E. WILLIAMS COMPANY,

Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Appeal from the Tax Court of the United States
Docket No. 5946-71
WILLIAM A. GOFFE, *Judge.*

ARGUED FEBRUARY 25, 1975 — DECIDED DECEMBER 16, 1975

Before FAIRCHILD, *Chief Judge*, and CUMMINGS and SPRECHER, *Circuit Judges.*

FAIRCHILD, *Chief Judge.* Don E. Williams Company appeals from a decision of the Tax Court. The parties stipulated to the facts, set forth in the Tax Court opinion, 62 T.C. 166 (1974). The Tax Court sustained the Commissioner's disallowance of income tax deductions claimed pursuant to §404(a) of the Internal Revenue Code of 1954, 26 U.S.C. §404(a), for contributions to a qualified employee profit-sharing plan.

The issue is whether an accrual taxpayer's delivery of its secured promissory note to the trustees of the plan constitutes "payment" within the meaning of §404(a)(6).

After §404(a)(3) authorizes deduction of contributions paid by an employer to a profit-sharing plan, within limitations as to amount, "In the taxable year when paid," §404(a)(6) provides:

(6) *Taxpayers on accrual basis.*—For purposes of paragraphs (1), (2), and (3), a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return of such taxable year (including extensions thereof).

Thus, while a cash basis taxpayer must make payment before the close of the taxable year in order to deduct a contribution, an accrual basis taxpayer is given a grace period extending beyond the close of the taxable year.

In the instant case, Williams Company, an accrual basis taxpayer, accrued on its books within the taxable year a liability for a contribution to a qualified employee profit-sharing fund. Within the time allowable for filing a return the company delivered its interest-bearing secured demand note to the trustees of the profit-sharing fund.¹ The note was secured by collateral consisting of stock in the company and the interests of two of the shareholders in the profit-sharing plan. The note was guaranteed by officers of the company. It was stipulated that the value of the collateral, combined with the net worth of one of the guarantors, exceeded the face value of the note.

The Tax Court sustained, with three judges dissenting, the Commissioner's determination that contributions made in the form of a taxpayer's promissory note did not qualify as "payment" under §404(a)(6). The majority of the court retained a position consistent with its earlier rulings, even in the face of reversals by several Courts of Appeals.² We affirm the Tax Court's decision.

¹ The Williams Company followed this procedure for the taxable years ending April 30, 1967; 1968; and 1969. The interest rates on the promissory notes were 6 percent, 6 percent and 8 percent, respectively.

² See *Logan Engineering Co. v. Commissioner*, 12 T.C. 860 (1949); *Slaymaker Lock Co. v. Commissioner*, 18 T.C. 1001 (1952), reversed sub nom. *Sachs v. Commissioner*, 308 F.2d 313 (3rd Cir. 1953); *Time Oil Co. v. Commissioner*, 26 T.C. 1061 (1956), reversed, 258 F.2d 237 (9th Cir. 1955); *Wasatch Chemical Co. v. Commissioner*, 37 T.C. 817 (1962), reversed, 313 F.2d 865 (10th Cir. 1963).

The Treasury Regulation interpreting §404(a) provides in part:

§1.404(a)-1 *Contributions of an employer to an employees' trust or annuity plan compensation under a deferred payment plan; general rule.*

• • •
• • •
• • •

(c) Deductions under section 404(a) are generally allowable only for the year in which the contribution or compensation is paid regardless of the fact that the taxpayer may make his returns on the accrual method of accounting. . .

• • •

This latter provision is intended to permit a taxpayer on the accrual method to deduct such accrued contribution or compensation in the year of accrual, *provided payment is actually made* not later than the time prescribed by law for filing the return for the taxable year of accrual (including extensions thereof), but this provision is not applicable unless, during the taxable year on account of which the contribution is made, the taxpayer incurs a liability to make the contribution, the amount of which is accruable under section 461 for such taxable year. See section 461 and the regulations thereunder. . . . (Emphasis added.)

We can see no difference in the way the statute and regulations treat the accrual basis and cash basis taxpayers for purposes of what constitutes "payment" except that the accrual taxpayer may make "payment" during the grace period if the liability to pay was incurred during the taxable year. As we interpret the statute, the grace period for accrual taxpayers does not change the type or nature of "payment" that is required. We are unable to justify accepting payment in the form of a promissory note for an accrual taxpayer when it seems clear that it would not be considered payment for the cash basis taxpayer.

The Supreme Court has stated that the issuance of a cash basis taxpayer's promissory note is not the equivalent of payment. In *Eckert v. Burnet*, 283 U.S. 140 (1931), where it was held that a cash basis taxpayer sustained

no loss in the year in which he gave his promissory note, the Court said:

As happily stated by the Board of Tax Appeals, the petitioner 'merely exchanged his note under which he was primarily liable for the corporation's notes under which he was secondarily liable, without any outlay of cash or property having a cash value.' A deduction may be permissible in the taxable year in which the petitioner pays cash. 283 U.S. at 141, 142.

In *Helvering v. Price*, 309 U.S. 409 (1940), the Court held that a cash basis taxpayer was not entitled to a loss deduction where the taxpayer substituted his new note for an earlier one in discharge of his guaranty obligation. Relying on *Eckert*, the Court stated:

We think that this decision [*Eckert*] is controlling in the instant case. As the return was on the cash basis, there could be no deduction in the year 1932, unless the substitution of respondent's note in that year constituted a payment in cash or its equivalent. There was no cash payment and under the doctrine of the *Eckert* case the giving of the taxpayer's own note was not the equivalent of cash to entitle the taxpayer to the deduction.

Respondent urges that his note was secured, but the collateral was not payment. It was given to secure respondent's promise to pay, and if that promise to pay was not sufficient to warrant the deduction until the promise was made good by actual payment, the giving of security for performance did not transform the promise into the payment required to constitute a deductible loss in the taxable year. See *Jenkins v. Bitgood*, 101 F.2d 17, 19. 309 U.S. at 413, 414. (Emphasis added.)

This court, in *Cleaver v. Commissioner of Internal Revenue*, 158 F.2d 342 (7th Cir. 1946), cert. denied, 330 U.S. 849, adopted the reasoning in *Eckert* and *Price* in denying a cash basis taxpayer a deduction for interest payments. The taxpayer had merely agreed to pay the interest in the form of a promissory note. "[N]o cash payment had actually been made; and . . . , therefore, the deduction for interest paid was improper." 158 F.2d at 344.

We think the legislative history of §404(a) supports the conclusion that the payment requirement is not fulfilled by the delivery of a taxpayer's promissory note. The Ways and Means Committee Report on the Revenue Revision Act of 1948 states: "An employer on the accrual basis of accounting may under existing law deduct contributions actually paid within the first 60 days of the subsequent year." 80th Cong. Rep. N. 2087, p. 13. (Emphasis added.) We interpret the emphasis on "actually paid" to connote a liquid form of payment and not a promissory note which is in substance only another form of an obligation to pay.*

In accord with this interpretation, the Tax Court in *Logan Engineering Co. v. Commissioner*, 12 T.C. 860 (1949) stated that the word "paid" as used in section 23(p), the predecessor of §404(a), should be given its ordinary and usual meaning: "to liquidate in cash." Similarly, the Fifth Circuit in *P.G. Lake, Inc. v. Commissioner*, 148 F.2d 898 (5th Cir. 1945), stated:

Where, as here, the definite word 'paid' is used in the statute we are not permitted by the theory of fiction to give to that word an indefinite meaning. . . . The ordinary and usual meaning of 'paid' is to liquidate a liability in cash. . . . 148 F.2d at 900.

Appellant cites cases from those circuits which have reversed the Tax Court on issues similar to the one under consideration. The Third Circuit in *Sachs v. Commissioner of Internal Revenue*, 208 F.2d 313 (3rd Cir. 1953), relying heavily on its prior decision in *Anthony P. Miller, Inc. v. Commissioner*, 164 F.2d 268 (3rd Cir. 1947), held that a solvent taxpayer's negotiable demand note delivered to a qualified pension fund constituted "payment" for purposes of §404(a). The *Miller* case dealt with the issue of whether a demand promissory note given by a corporation to one of its officers was "payment" of a salary within the meaning of section 29(c)(1), the predecessor of 26 U.S.C. §267. Besides relying on *Miller*, the court in *Sachs* reasoned that since the demand notes were payable at

* Congress has with some frequency used the phrases "paid or incurred" and "paid or accrued" in those sections of the tax code where a cash or cash equivalent payment is not needed for an accrual basis taxpayer. See, for example, 26 U.S.C. §§164(a), 174(a)(1), 163(a), 175(a), 212, 216(a).

a bank and since the Commissioner of Internal Revenue had no objection to payments made in the form of a check, it "could see no reason why a negotiable demand note payable at a bank is not likewise sufficient." 208 F.2d at 315.

To the extent that the *Sachs* decision rests on the reasoning that the demand note was equivalent to a check, it may be distinguishable from the instant case as well as the other cases cited by appellant. Under Pennsylvania law, at issue in the *Sachs* case, the bank at which a note is payable on demand is to pay the note upon presentment out of available funds. Pa. Stat. Ann. Title 12A, §3-121. Uniform Commercial Code §3-121, alternative A. However, under Illinois law, as well as in the other jurisdictions cited by appellant, a note that states it is payable at a bank does not itself authorize the bank to make payment. Ill. Rev. Stat. Chp. 26, §3-121 (1973), Uniform Commercial Code §3-121, alternative B.

Time Oil Company v. Commissioner of Internal Revenue, 258 F.2d 237 (9th Cir. 1958), (reversing 26 T.C. 1061), also cited by appellant, deals with the same question of whether a taxpayer's note is "payment" within the meaning of section 404(a). The court conceded the issue to be a close one, but after reviewing the *Sachs* decision saw no reason to create a conflict among circuits and therefore held that the delivery of the note constituted payment.

The court in *Wasatch v. Commissioner*, 313 F.2d 843 (10th Cir. 1963), (reversing 37 T.C. 817), reached a similar conclusion. The issue in that case dealt with notes that had a stated maturity date as opposed to demand notes which were discussed in the *Sachs* and *Time Oil* decisions. The court found no difference in the principles involved between the two types of notes for purposes of section 404(a). The court said:

Any note has a value at the time of delivery ranging from zero upwards which can be determined. This is the ordinary business consequence of the delivery of a promissory note, this is the value which here changed hands on delivery, and this is the value which was here 'paid' under Section 404 313 F.2d at 847.

The appellant also relies on *Advance Construction Co., Inc. v. U.S.*, 356 F.Supp. 1267 (N.D. Ill. 1972), a district court case involving a suit for a tax refund. The court held that a taxpayer's term promissory note was a proper form of contribution under §404(a). The court reasoned that while cash is the "most undisputed manifestation" of payment, there also exists a whole spectrum of possible cash substitutes which could qualify as a "payment." The court said:

. . . an obligation need not be satisfied in cash or in a form of cash so long as there is a transfer of something that has a current 'cash value'. Hence there are many substitutes for cash that can be considered as 'payment'. What is primary is not the form of cash payment but rather cash value. 356 F. Supp. at 1271.

The court concluded that a mere promise to pay without any physical evidence of that promise was too intangible to represent a transfer of "current cash value." However, if the promise was evidenced by a promissory note, then the court reasoned it could find "a physical transfer of something of value." 356 F.Supp. at 1271.

We respectfully decline to follow the Third, Ninth, and Tenth Circuit decisions and the district court decision cited by appellant.* The interpretation of "payment" as found in the Supreme Court decisions of *Eckert* and *Price* and our own decision in *Cleaver* seems to us to be the more defensible view in light of the legislative history and administrative construction. In view of the persistence of the Commissioner and the Tax Court in the face of several reversals, we do not treat this as a situation in which long standing and consistent interpretations of other circuits have merged into the meaning of the statute.

Practical considerations also favor a narrow construction of the "payment" requirement of §404(a). Although payment may be made in property other than cash, and evaluation of such property is necessary, an interpretation which excludes the giving of the taxpayer's promissory

* Because of the conflict, this opinion has been circulated to all judges of this court in regular active service. No judge has requested a vote on the question whether the adoption of the conflicting view should be reheard en banc.

note will substantially reduce the problem of evaluation for the Commissioner and the courts.³

We hold that the "payment" requirement of section 404(a) Internal Revenue Code is not fulfilled by the delivery of an accrual taxpayer's secured interest-bearing demand promissory note. The judgment appealed from is affirmed.

A true Copy:

Teste:

.....
*Clerk of the United States Court of
Appeals for the Seventh Circuit*

³ Although the question presented is one of federal law, our holding is also consistent with the Uniform Commercial Code §3-802, adopted by Illinois, which provides in part that generally an instrument taken for an underlying obligation suspends the obligation until the instrument is due or, in the case of a demand note, until the note is presented.

APPENDIX C

Judgment Order Of United States Court Of Appeals For The Seventh Circuit

OPINION BY JUDGE FAIRCHILD

United States Court of Appeals
For the Seventh Circuit

December 16, 1975

Before

HON. THOMAS E. FAIRCHILD, *Chief Judge*
HON. WALTER J. CUMMINGS, *Circuit Judge*
HON. ROBERT A. SPRECHER, *Circuit Judge*

No. 74-1812

DON E. WILLIAMS COMPANY,

Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Appeal from the Tax Court of the United States.
Docket No. 5946-71 — William A. Goffe, Judge.

This cause came on to be heard on the transcript of the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decision of the Tax Court of the United States entered in this cause on May 15, 1974, be, and the same is hereby, affirmed, in accordance with the opinion of this Court filed this date.
